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DIRECTORATE OF INTELLIGENCE

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Yugoslavia: Financial Outlook

Summary

The Western financial rescue package was assembled to provide Yugoslavia enough time and money to make needed adjustments that would restore financial solvency. Our projections of this year's balance of payments indicate that:

- The Yugoslavs will be unable to earn enough through exports and invisibles to meet the IMF projection of a $500 million current account deficit. We estimate that even with a $1 billion cut in imports the deficit would run $725 million, down from last year's $1.4 billion.

- The package will cover this year's financing needs and increase reserves by $280-$520 million depending upon the level of imports and the useability of the Western credits provided. This will not yield enough reserve build-up, however, to put Yugoslavia on a solvent footing for next year. [redacted]

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This memorandum is for the exclusive use of Under Secretary of State, Lawrence Eagleburger. This memorandum was prepared by [redacted] East European Division, Office of European Analysis. Comments and questions are welcome and should be addressed to [redacted] Chief, East European Division, Office of European Analysis, [redacted]

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We do not believe that the improvement in the balance of payments during 1983 will persuade private lenders to provide a sufficient amount of new loans to cover a financing requirement of $2 to $2.3 billion in the first half of 1984. Given the difficulties in arranging this year's rescue package, we see little enthusiasm among private banks as well as some foreign governments to undertake a similar effort in 1984. This reluctance is likely to be strengthened by Yugoslav failure to meet fully its IMF-mandated targets and the current account projections for 1983. In late 1983 or early 1984, therefore, Western creditors may decide to press Belgrade to begin a formal rescheduling of its debts. [redacted] 25X1 25X1

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Lower Earnings

We believe that the YNB current account projection is too optimistic. Export growth will be no more than the IMF projection, and we estimate it could be as low as 5 percent. Although hard currency sales are up 17 percent through April over the first four months of 1982, we believe that growth will slow sharply over the rest of the year because:

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- the first months of 1982 are an exceptionally low base from which to calculate the increase in exports;

- a downward trend in the rate of growth of exports has already appeared since February, when exports were reported up 28 percent. The increase in March and April over the same months last year slowed to 11 percent; and

- industrial output reportedly is down 0.9 percent through April and we believe it will continue to slide as sharp import cuts and austere economic policies have their impact. 25X1

In our judgment, Belgrade is too optimistic about earnings from tourism as well since recovery from last year's low levels is unlikely. The success of the tourist season depends on the second half of the year when three-fourths of revenues accrue. Advanced bookings for tour packages--35 percent of Yugoslavia's foreign visitors--reportedly were down 25 to 30 percent as of the end of February compared to the same period last year. We also expect net workers' remittances to decline by 30 percent in 1983 as Yugoslavs react to the limits placed on hard currency deposit withdrawals last year and anticipate new restrictions on the use of foreign exchange. 25X1

Our estimate thus assumes that Yugoslavia's current earnings could fall as much as $900 million below the YNB forecast. This would confront the Yugoslavs with a difficult choice.

- Maintain a tight lid on imports over the rest of the year to meet the IMF forecast for the current account deficit and buildup of reserves; or

- Permit a higher level of imports and abandon the IMF goals. 25X1

We believe the Yugoslavs will have to import less than the NBY projects if only out of concern over future liquidity and for the effect of a large current account deficit on lender attitudes. Hard currency shortages already have held imports through mid-April to 18 percent below last year's level. An import reduction on the order of 10 percent for the year as a while would yield a current account deficit of $725 million and a financing requirement of $5.8 billion. The pace of imports should pick up, however, over the balance of the year as the financial rescue package is disbursed. Because current import reductions are hitting very hard at the less solvent republics, Yugoslav officials fear that the incipient slide in industrial

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production could accelerate disastrously in the second half of the year without some revival of imports.

Financing Sources

Completion of the US-sponsored international rescue package--calling for over $6 billion in debt relief and new loans from private and official creditors--is proving difficult. Some Western governments have yet to provide credits pledged under the "Friends of Yugoslavia" program. Commercial bankers have been concerned that governments have not shouldered an equitable share of the burden. 25X1

Although more delays are possible, we believe that the rescue package will fall into place during the third quarter of this year. A key uncertainty is how much of the government-backed trade credits Yugoslavia can use. The Yugoslavs insist that they probably cannot use all the loans because some of the credits are tied to purchases of capital goods which Yugoslavia does not plan to buy. The YNB now plans on using only $750 million of the $1.0 to $1.1 billion in government trade credits, thereby reducing financing sources to $6.1 billion. If Yugoslavia can in fact use all the credits, we estimate total financing sources will rise to $6.4 billion. 25X1

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Reserves. The Yugoslav National Bank's reserve holdings will be the critical indicator of the country's liquidity situation. The lack of a foreign exchange market and the tendency of the better managed banks to hoard their reserves will force illiquid banks to depend on the National Bank for hard currency. By the end of the year the National Bank's effective reserves, those reserves that are available to meet liquidity needs, probably will range between $400 and $800 million (depending on Yugoslavia's ability to use the Western government trade credits and on how much the National Bank replenishes other accounts earmarked for specific purposes).

First Half 1984 Balance of Payments Outlook

Assuming Western bankers maintain their short-term exposure as pledged in the 1983 bank refinancing package, Yugoslavia probably will have a financing requirement of $2 to $2.3 billion in the first half of 1984. The IMF projects $1.2 billion in long and medium-term capital repayments and the extension of $100 million in net long-term loans by Yugoslavia during this period. The IMF estimates the current account deficit to be $700 million, while we believe it could run as high as $1 billion.

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Even if the Yugoslav National Bank exhausts its holdings of uncommitted foreign exchange to meet the financing requirement during the first half of the year, external financing of some $1.2 to $1.9 billion will be required to prevent major arrearages. [redacted] 25X1 Bankers will remain cautious about new lending because of:

- o Yugoslavia's likely failure to meet the 1983 IMF current account target of a $500 million deficit;
- o Belgrade's inability to curb inflation and deal with other domestic economic problems;
- o uncertainties about a new IMF stabilization program and lending facilities; and
- o widespread belief that the country needs more debt relief. 25X1

We believe some Western creditors may be inclined to force Belgrade into a formal rescheduling in 1984. Because of the problems in this year's rescue effort, commerical bankers seem increasingly convinced that rescheduling is the only way to ensure equitable burdensharing among all creditors. Western governments that reluctantly accepted the "Friends of Yugoslavia" package--particularly the West Germans and the British--may insist that Yugoslavia's problems be addressed in the Paris Club. 25X1

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Yugoslavia: Hard Currency Financing Needs
(in million of dollars)

TABLE 1

	1982	1983 IMF Projection	1983 Yugoslav Projection late March	1983 CIA Projection
Financing requirement	5585	5,700	5,572	5,850
Current account balance	-1420	-500	-564	-725
Trade balance	-3779	-2,300	-2,979	-2,525
Exports	5858	6,300	6,471	6,150
Imports	9637	8,600	9,450	8,675[2]
Net invisibles	2359	1,800	2,415	1,800
Net invisibles, excluding interest	4,319	3,800	4,365	3,750
Net interest	-1,960	-2,000	-1,950	1,950
Repayment of short-term credit	-2300	-2,000	-1,800	-1,800
Repayment of medium and long-term debt	-1690	-2,500	-2,898	-2,625
Credits Extended (net)	-175	-200	-150	-200
Arrearages as of Jan 1, 1983	NA	-500	NA[1]	-500
Errors and Omissions	-	-	-160	-
Financing Sources	4,573	6,328	6,130	6,370
1983 Western rescue package			5,941	6,170
IMF			604	620
IBRD			450	400
Governments loans			1,087	1,350
Financial credits			333	300
Export credits			754	1,050
Banks			3,800	3,800
New loans			600	600
Short-term rollover			1,800	1,800
Medium and long-term rollover			1,400	1,400
Other			189	200
Change in reserves	-1,012	628	558	520

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[1] Most recent Yugoslav projection does not show repayment of arrears explicitly. They seem to be included in repayments of medium and long-term debt and possibly in errors and omissions.

[2] Because of our lower projection for current account earnings, this is the maximum level Yugoslavia can import and still achieve a $500 million buildup of reserves. Imports may be even lower if Yugoslavia cannot use all the government export credits provided in the rescue package.

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